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Investment bankers' association

Draft of a bill to regulate the sale of
securities.

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DRAFT OF A BILL TO REGULATE THE SALE OF SECURITIES AND A DISCUSSION OF THE MEASURE

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INVESTMENT BANKERS ASSOCIATION OF AMERICA

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Resolution Adopted at Baltimore on the Second of February, 1913, by the Board of Governors of the Investment Bankers Association of America.

That people dealing in securities in bad faith should be put out of business is now a conspicuous object of public desire, and one of the definite purposes of this Association. Such dealers are defeated when publicly pointed out. To this end it is necessary that there be those who are constantly interested and alert. With vigilant activity special statutes are unnecessary. This Association represents those who have a strong and enduring interest in the suppression of illegitimate dealing in securities.

For many months the Association has been studying the state of the law throughout the country to ascertain whether new legislation of any type, specifically upon this subject, would improve the existing means of accomplishing the desired end. This Association believes that the present law in some of the states is adequate. Where this is true additional legislation is superfluous and therefore unwise. The American tendency is toward over-legislation. The need is for more effective action, rather than for the provision of further mechanism.

Some states will certainly enact statutes to regulate the sale of securities popularly known as Blue Sky laws. It is important in the interest of the investing public, of the issuers of industrial and other corporate securities, and, of course, in the interest of honest dealers, that the

statutes accomplish their essential object without placing undue burden on, or causing undue delay in the immense daily volume of legitimate transactions. The facts about the manner in which the Investment business of this country is carried on ought to be considered with great care by those drafting Blue Sky bills. Because it has this information, this Association is in a position to suggest a type of Blue Sky law which will cause as little embarrassment to honest dealers, with whom no one desires to interfere, as may be, without impairing the effectiveness of the measure. By way of illustration, the Legislative Committee of this Association has drafted a bill, copies of which will be supplied to members, and upon request to others. Of course it is not expected that this draft will be acceptable in every detail, and in every state where Blue Sky legislation is deemed essential, but it is believed that the draft, and the Committee's discussion of it, will be helpful to any careful constructive study of the subject.

Discussion of the Draft of a Bill to Regulate the Sale of Securities.

Any measure to regulate the sale of securities should be as simple as possible. An investment banker ought to be able to find out from reading the statute what he should do to comply with the law.

It should not hamper legitimate business more than necessary. Whatever its purpose, it should not interfere with the freedom of business intercourse between the states. The work of investment banking is so complex that ill-advised measures could easily entangle it to such an extent that it could not be carried on. Even this draft imposes a considerable burden on the honest dealer. Also many of the "blue sky" bills introduced in the legislatures would operate in fact to restrict competition in the investment business. Any measure requiring the payment of a registration fee of appreciable size or imposing too burdensome requirements as a preliminary to doing business, or compelling an examination and approval of each security before it may be offered for sale, will inevitably tend to narrow the number of dealers seeking to do business, and the number of sound securities in which the citizens of the enacting state may invest.

If any legislation to regulate the sale of securities is enacted, it should, however, furnish a real weapon against the unscrupulous vendor of securities. It should be enacted especially with a view of protecting the small investor who cannot afford to make an investigation on his own account, and whose unfamiliarity with financial affairs does not give him a sufficient basis for discrimination between good and bad faith among those offering him securities.

GENERAL PLAN OF THE BILL.

It seems the best central idea for carrying out these considerations to give some state officer or commission a right to issue an order to any dealer not to offer in the state securities which seem not to be offered in good faith. In order to remove any apprehension of arbitrariness the draft expressly provides a right of appeal to the courts.

In carrying out this thought, the draft provides for the filing of certain definite information as a prerequisite of doing business in the state except in specially exempted securities. It seems desirable to make this initial requirement simple to comply with, in order to allow a reasonable freedom of dealing in legitimate securities. If, for example, a dealer should, as a result of established reputation, or of magazine advertising, receive an order from a distant state, the dealer could fill the order by simultaneously filing the information definitely required by Section 1. This information would give notice to the state officer of the dealer's doing business in the state, and give the officer an opportunity to investigate if he wished. Some bills have been drawn requiring a prior registration of dealers and a prior approval of securities by the Commissioner. This method proceeds on the assumption that the Commissioner can automatically prevent any wrongful sale of securities. Such a result seems to be impossible, and if it were attainable, its superiority over the restrictive method would hardly be worth the expense and machinery necessary for its execution, even if we ignore its injury to the freedom of honest business between citizens of different states. This bill places an effective weapon in the Commissioner's hands, with which he can quickly drive an unscrupulous dealer out of business. The mere existence of a weapon of this kind should be sufficient to keep such dealers

out of the state. Under the method now proposed, the law can properly subject all dealers to the investigation and orders of the Commissioner.

If a permit should be required as a prerequisite to doing business, it would be impossible for an investment banker to put through the transaction just indicated. It might require a week or more before an applicant, even of such high reputation that a permit would be a matter of course, could get notice that he might go ahead. An investor would not do business under such conditions.

The proposed legislation makes it the definite business of some state officer to watch carefully securities offered for sale in the state, and to make any dealer under suspicion of not acting in good faith furnish full information and otherwise submit to investigation.

A state making the conditions of business too onerous through the imposition of heavy fees and the requirement of extensive preliminary disclosures, although the dealer may be well known as above suspicion, would militate against its own welfare. If it should make its act apply to all dealers both in and out of the state, many outside dealers, each doing in the state a small business, but in the aggregate large, could not afford to comply with the act, and the inhabitants of the state would be deprived of the benefit of their competition. It would not be worth while for any dealer to advertise in periodicals of wide inter-state circulation, because, on account of the states in which he would be barred from doing business, the value of the advertising would be so largely lost. The fee, if any, should be very small. The regulation is for the benefit of all the citizens and there is no special reason for the class being regulated standing the expense of the regulation.

The fake investment proposal bears certain earmarks. It does not often give a balance sheet and income account

or much other definite information. In order to be successful it must ordinarily promise exceptional rewards, and in many other ways show reason for suspicion to one trained in financial matters. If the bill provides some means for calling the offering to the attention of the state, and gives the state a right to investigate, and the state exercises that right, it can exclude the evildoer without crippling the honest investment banker.

TO WHOM THE BILL SHOULD APPLY.

It seems only fair that the bill should apply to all who make a business of dealing in securities.

BANKS.

If a bank actually makes a business of dealing in securities, there seems hardly sufficient reason for exempting it from provisions of the bill. Unscrupulous men might organize a bank and conduct a fraudulent securities business under its cover for as long a time as some fraudulent concerns have done business in the past before reached under the present laws.

BROKERS.

Brokers present one of the difficult problems in drafting a bill. In the ordinary course they merely act as intermediaries between buyers and sellers in transactions, which, if the principals met face to face, would be a matter of personal business. Yet, on account of the possibility of working fraudulent schemes through brokers, it seems undesirable that they should be exempted from the provisions of a bill aimed at the prevention of fraud in security selling. To include them in the kind of bill proposed would not unduly hamper their work.

THOSE WHO MAKE A BUSINESS OF DEALING
IN SECURITIES.

It is thought that it will not be impracticable to distinguish between the dealer and the buyer and seller of securities in the ordinary course of personal investment or speculation. It is true that insurance companies, banks, and individuals may be actively engaged in the buying and selling of securities, but it would seem not too difficult to distinguish between those who do this as a matter of investment or speculation, and those who are regularly engaged in doing it as an occupation.

EXCEPTING LEGITIMATE SECURITIES.

The aim should be to narrow the act to newly issued securities and those of doubtful value, bearing in mind that if the penalties are made effective a dealer will not take chances in selling securities that are not very clearly excepted from the act, without complying with it.

To leave federal, government and state bonds within even the apparent scope of the bill would seem absurd. Municipal bonds are also a recognized class of investments entirely outside of the purpose of this legislation. These have been excepted by the proposed draft. The larger our classification of clearly proper investments excluded, the more effective the act will prove in its operation against doubtful securities. Any particular state can readily make further exceptions by such classification and definition as may serve the purpose. If a right to call for information is reserved, and a penalty provided for attempting fraud, it would seem desirable to make further exemptions from the act, with a view to concentrating its force upon new or uncertain securities. The exceptions in Section 8 (b) are merely suggestive, and are subject to the right of investigation under Section 3.

UNDERWRITING.

The success of underwriting transactions may depend on secrecy. It is believed that the bill as drawn exempting from the provisions of Section 3 securities offered only to dealers or banks protects these transactions, so far as they can be protected, without leaving the door open to fraud under the guise of syndicate operations.

Modifications or changes of these provisions, may be made to meet the special situation in any particular state.

A BILL TO REGULATE THE SALE OF STOCKS, BONDS
AND OTHER SECURITIES.

SECTION 1. No dealer in stocks, bonds, debentures, certificates of participation, or other securities, shall in this state, sell, offer for sale, invite offers for, or inquiries about such securities by personal solicitation letters or circulars, except to other dealers or banks, or by advertising in any newspaper, magazine or other periodical published in this state, until such dealer has filed with the Commissioner of Banking:

(a) A statement under oath showing the name and principal place of business of such dealer, and the names, residences and business addresses of all persons interested as principals, officers, directors or trustees, including the name, residence and business address of an agent residing in this state, if any.

(b) Two certificates each signed by different persons who shall be officers of different state or savings banks or trust companies within this state, or of national banks, stating that in their opinion the dealer is of good business repute and financial standing.

(c) If such dealer is non-resident, a designation duly signed which by its terms shall be irrevocable so long as the dealer shall in this state do any of the acts named in this section, designating a resident agent, or the Commissioner, attorney for the dealer for the service of any legal process.

SECTION 2. By an order directed to any such dealer the Commissioner may require such dealer, whenever he shall offer any security or securities in this state, except to other dealers and banks, to file with him a statement

showing the security or securities so offered, and the Commissioner may by such order require such dealer to mail to him, as soon as any copies are so mailed or shown to any prospective purchaser in this state, a copy of all printed or otherwise reduplicated circulars of any security or securities the dealer shall offer for sale in this state, including a copy of all advertisements thereof inserted in any newspaper, magazine or other periodical published in this state. The Commissioner may limit such an order to securities of any particular class or character on which he may deem such information necessary.

SECTION 3. The Commissioner may at any time order a dealer to file with him evidence, including a statement under oath of assets and earnings or other information in relation to any security the dealer is offering for sale, or inviting offers for, except to other dealers or banks, or advertising in newspapers, magazines or other periodicals published in this state, sufficient to show that the offering or invitation has been and is being made honestly and in good faith, and with disclosure of pertinent facts sufficient to enable intending purchasers to form a judgment of the security. Unless such evidence is filed and is sufficient, as stated, the Commissioner may order the dealer not to offer the security for sale or otherwise advertise it in such publications or circularize it in this state.

SECTION 4. On ordering a dealer not to sell, offer for sale, circularize, or advertise in such publications in this state, any security, the Commissioner must send notice to the dealer by registered mail addressed to the dealer's principal place of business, stated as required under Section 1, or to such address as the dealer may designate for that purpose, stating the reasons therefor.

On receiving such an order from the Commissioner, the dealer may apply to a judge of the..... Court for an order addressed to the Commissioner of Banking to show cause why the Commissioner's order should not be revoked, and upon such application the decision or determination of the Commissioner as to any matters or things involved in such order, may be reviewed by such judge, and he may suspend the Commissioner's order pending the determination of the application, and make such provision as justice may require for the summary hearing and determination thereof.

SECTION 5. Any dealer or agent of a dealer wilfully violating the provisions of this act upon conviction thereof shall be punished by a fine of not more thanand if such violation is with intent to defraud, by imprisonment for not more than.....

SECTION 6. Every sale or contract of sale in violation of Section 1, or of any order issued under Section 3 of this act shall be void, and the dealer making such contract or sale must on request and tender back of any securities received, return the purchase price or any part thereof paid.

SECTION 7. A corporation or unincorporated association offering its own securities for sale by circular, advertising, or through agents, except to its own shareholders or members, or to dealers, or banks, or by such means inviting offers for or inquiries about its securities, shall be considered a dealer under the terms of this act.

SECTION 8. The provisions of this act shall not apply to:

- (a) Bonds or other evidences of indebtedness of the United States or any foreign government.

Bonds or other evidences of indebtedness of any State or territory of the United States or any foreign government.

Bonds or other evidences of indebtedness of any County, City, Township, Village, District or other political or taxing subdivision of any State or territory of the United States or any foreign government.

Commercial paper or evidences of indebtedness running not more than nine months.

Bonds, stocks or other securities of quasi-public corporations, the issue of whose securities is regulated by a Public Service Commission or Board of any State or territory of the United States or any foreign government.

***(b)** The following securities unless, and to the extent that, the Commissioner includes them in any order under Sections 2 or 3: Securities, including stocks, issued by any railroad, steamboat, gas, electric light, or other public service corporation, actually in operation over three years or having assets, exclusive of franchises, patents and good will, exceeding Two hundred thousand dollars in value, or securities, including stocks issued by any other corporation or association having net assets exclusive of franchises, patents and good will exceeding Three hundred thousand dollars in value.

SECTION 9. If a dealer shall sell, offer for sale, invite offers for or inquiries about any securities including those mentioned in Section 8 with intent to defraud he shall, however, be deemed guilty of violating this act and subject to the penalties hereof.

SECTION 10. This act shall go into effect the..... day of.....

* The exceptions in Section 8b are merely suggestive. They may be modified to meet local requirements and conditions.







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